

STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF EXAMINATION

OF

CASUALTY UNDERWRITERS INSURANCE COMPANY

OF

SALT LAKE CITY, UTAH

as of

June 30, 2004



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July 22, 2005

Honorable Kevin McCarty, Director of Insurance Regulation
Chair, Financial Condition (EX4) Committee, NAIC
Florida Department of Financial Services
The Larson Building
200 E. Gaines Street, Room 101
Tallahassee, Florida 32399-0301

Honorable John Morrison, Commissioner
Secretary, Western Zone, NAIC
Montana Department of Insurance
840 Helena Avenue
Helena, Montana 59601

Honorable D. Kent Michie, Commissioner
Utah Insurance Department
3110 State Office Building
Salt Lake City, Utah 84114-6901

In accordance with your instructions and in compliance with Utah Code Annotated (UCA) Title 31A, an examination was conducted as of June 30, 2004, of the financial condition and business affairs of

CASUALTY UNDERWRITERS INSURANCE COMPANY

of
Salt Lake City, Utah

a stock property and casualty insurance company, hereinafter referred to as the Company, and the following report of examination is respectfully submitted.

Scope of Examination

Period Covered by Examination

The Company was last examined as of December 31, 1999, by a representative of the State of Utah Insurance Department. The current examination covers the intervening period from January 1, 2000, through June 30, 2004, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination.

Examination Procedures Employed

The examination was conducted to determine compliance with accounting practices and procedures in conformity with the applicable laws of the State of Utah, insurance rules promulgated by the State of Utah Insurance Department (Department), and Statements of Statutory Accounting Principles (SSAPs) contained within the Accounting Practices and

Procedures Manual promulgated by the National Association of Insurance Commissioners (NAIC).

The examination included a general review and analysis of the Company's operations, the manner in which its business was conducted during the examination period and a determination of its financial condition as of June 30, 2004. Assets were verified and valued, and liabilities were determined or estimated.

The Company retained the services of a certified public accounting (CPA) firm to audit its financial records for the years under examination. The firm allowed the examiner access to requested work papers prepared in connection with its audits. Limited reliance was placed on the work papers, since this examination was as of June 30, 2004, and the most recent CPA audited financial statement date was as of December 31, 2003.

A letter of representation, certifying that management has disclosed all significant matters and records, was obtained from management and has been included in the examination work papers.

Status of Adverse Findings, Material Changes in the Financial Statement, and Other Significant Regulatory Information Disclosed in the Previous Examination

Important points and recommendations noted in the prior examination report have been addressed by the Company.

History

General

The Company was organized on May 28, 1986, under the name of Commercial Underwriters Insurance Company. It was issued a certificate of authority to transact property and general casualty, without workmen's compensation insurance business, in the State of Utah on May 30, 1986. The Company's articles of incorporation were amended on October 31, 1986, to change the corporate name from Commercial Underwriters Insurance Company to Casualty Underwriters Insurance Company.

Article IV of the articles of incorporation was amended on September 15, 1989, to change the par value of the Company's common stock from \$1.00 per share to \$1.60 per share. This article was amended again on August 13, 1993, to increase the number of authorized shares from 562,500 shares to 1,000,000 shares.

Company operations were maintained in Salt Lake City, Utah, and Goddard, Kansas, until April of 1988. Subsequently, operations were consolidated with other affiliates in Kansas with the permission of the Utah Insurance Department.

There were no amendments to the articles of incorporation or the bylaws during the years under review.

Capital Stock

The total number of outstanding shares of the Company's common stock was 625,000 with a par value of \$1.60 per share. The Company was a wholly owned subsidiary of American Underwriters Life Insurance Company, an Arizona insurance company.

Dividends to Stockholders

No ordinary or extraordinary dividends were declared or paid during the period of examination.

Management

Article VI of the Company's articles of incorporation stated "The number of Directors shall be at least five, with the maximum number as set by the Board of Directors from time to time." Directors serving as of June 30, 2004, were as follows:

<u>Name and Residence</u>	<u>Principle Occupation</u>
Robert Kellie Hawkins Las Vegas, Nevada	President - Inter-Americas Insurance Corporation President – American Underwriters Life Insurance Company Chairman of the Board and Chief Executive Officer – Casualty Underwriters Insurance Company and Inter-Americas Insurance Corporation
Norma Jean Hawkins Las Vegas, Nevada	Secretary/Treasurer - Inter-Americas Insurance Corporation Secretary/Treasurer – American Underwriters Life Insurance Company Secretary/Treasurer – First Financial Insurance Company
Ronald Kellie Hawkins Wichita, Kansas	Executive Vice President – Inter-Americas Insurance Corporation Executive Vice President – American Underwriters Life Insurance Company Executive Vice President – First Financial Insurance Company President – Casualty Underwriters Insurance Company
Cindy Ann Hawkins Wichita, Kansas	Accounting Manager – American Underwriters Life Insurance Company Secretary – Casualty Underwriters Insurance Company
Arthur Oleen Dummer Sandy, Utah	President – The Donner Company

Sherri Lynn Fouts
Goddard, Kansas

Vice President – Inter-Americas Insurance
Corporation
Vice President – Casualty Underwriters
Insurance Company

Bruce Floyd Welner
Wichita, Kansas

President & Chief Operations Officer – Inter-Americas
Insurance Corporation
Senior Vice President and Chief Operations Officer -
American Underwriters Life Insurance Company
Senior Vice President – Casualty Underwriters
Insurance Company

Marcus William Dummer
Urbandale, Iowa

Relationship Manager – Principal Global Investors

The Company's bylaws provided that the officers of the Company shall be a chief executive officer, president, secretary and treasurer. These officers were to be elected annually by a majority of the board of directors. The officers serving as of June 30, 2004, were as follows:

<u>Name</u>	<u>Title</u>
Robert Kellie Hawkins	Chairman of the Board and Chief Executive Officer
Ronald Kellie Hawkins	President
Cindy Ann Hawkins	Secretary
Janice Marie Kelty	Treasurer
Bruce Floyd Welner	Senior Vice President

As of December 15, 2004, Cindy Ann Hawkins was elected to serve as the Company's secretary/treasurer due to the retirement of Janice Marie Kelty.

The Company was exempt from the requirement of an audit committee pursuant to UCA 31A-5-412(2) in that all outstanding shares of common stock entitled to vote were owned by a single person pursuant to UCA 31A-5-407(4).

Conflict of Interest

The Company required officers and directors to complete conflict of interest certificates on an annual basis. A review of these certificates for the years 2000, 2001, 2002, 2003 and 2004 revealed no exceptions.

Corporate Records

The board of directors met at least twice a year over the examination period. Minutes of the board of directors were reviewed and adequate review and approval of Company transactions was given. The board did review the prior financial examination report.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales through Reinsurance

The Company was not a party to any acquisitions, mergers, disposals, dissolutions and purchase or sales through reinsurance during the examination period.

Surplus Debentures

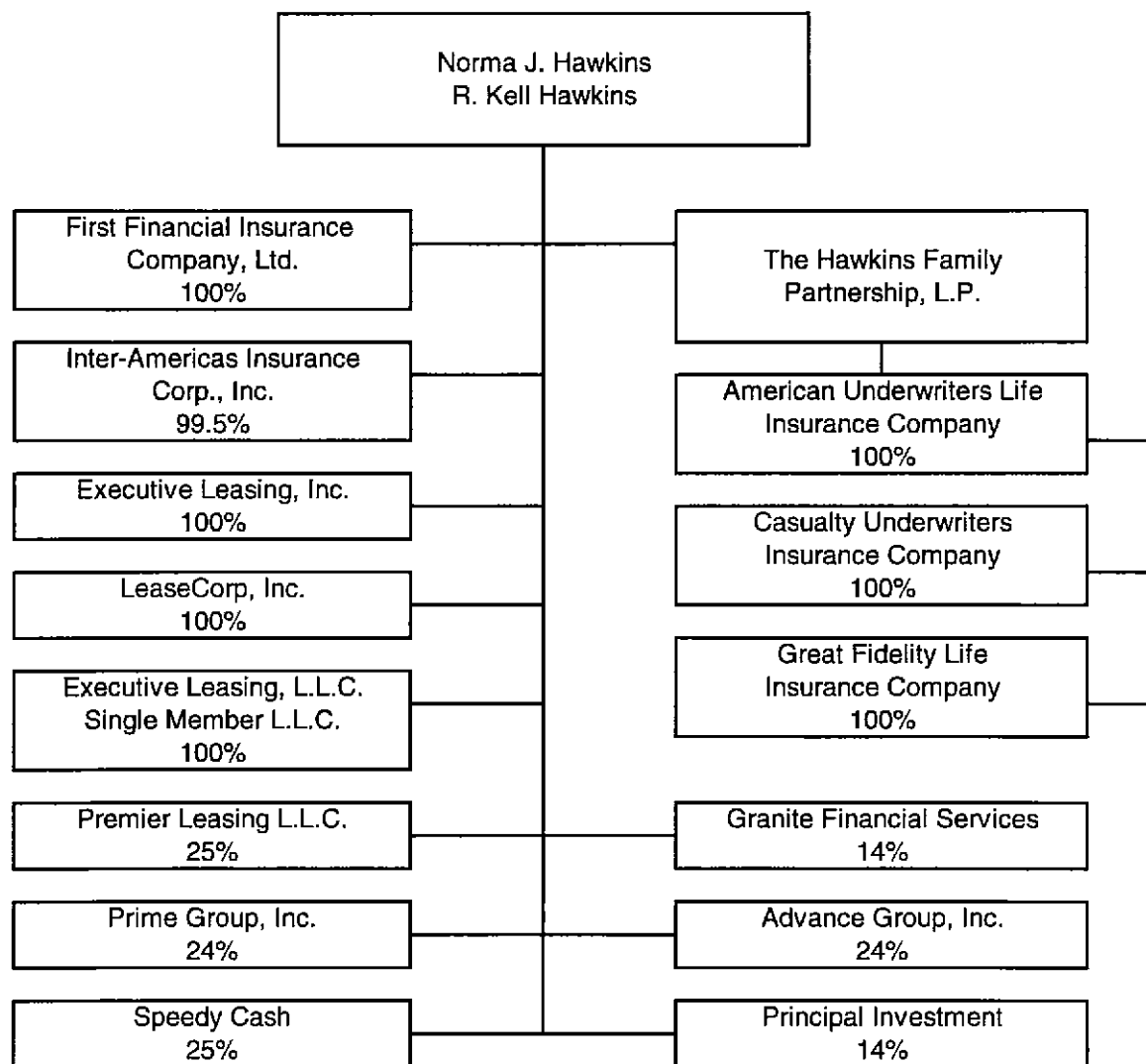
The Company did not have any surplus debentures outstanding as of June 30, 2004, nor were any surplus debentures issued or redeemed during the examination period.

Affiliated Companies

Holding Company System

The Company became a member of an insurance holding company system on the date of its incorporation, May 30, 1986. It was 100% owned by American Underwriters Life Insurance Company (AUL), an Arizona insurance company, as of June 30, 2004.

An organizational chart presenting the identifications of and interrelationships between the parent, affiliated insurers and other affiliates on June 30, 2004, is shown below.



First Amendment To Management Services Agreement

This agreement was made with the Company's parent, AUL, on February 1, 2003. AUL agreed to provide certain management services related to the operation of the Company's business for a flat fee of \$10,000.00 per month.

Marketing Services Agreement

This agreement was made with Inter-Americas Insurance Corporation, Inc. (IAI), an affiliate on June 1, 1997. IAI agreed to provide certain marketing services related to the operation of the Company's business for a fee that was defined to be a percentage of the premiums produced by IAI agents. The percentage was defined in a document entitled "New Business Reports" for each account.

Consolidated Tax Allocation Agreement

The Company with Great Fidelity Life Insurance Company and AUL formed an "Affiliated Group" for the purpose of filing consolidated federal income taxes for the tax year ended December 31, 2002, and subsequent tax years. In the agreement, AUL promises to file a consolidated federal income tax return on behalf of the "Affiliated Group."

Reinsurance Agreements

The Company had three quota share agreements in effect as of June 30, 2004, ceding various classes of insurance to its affiliate, First Financial Insurance Company, LTD, (First Financial), an unauthorized off-shore reinsurer of the island of Nevis (Leeward Islands), as follows:

- 33 1/3% of its non-standard auto insurance,
- 50% of its binder insurance (short term collateral protection insurance),
- 100% of its credit fire insurance.

Fidelity Bond and Other Insurance

The Company carried fidelity bond coverage of \$100,000 as of June 30, 2004, which was in excess of the minimum amount required using guidelines provided in the NAIC's Examiners Handbook. The Company was named as an insured on policies providing for commercial umbrella liability, commercial inland marine and commercial automobile coverage.

Pension, Stock Ownership and Insurance Plans

The Company did not have any employees. All managerial services were provided under an agreement with its parent, and all marketing services were provided under an agreement with an affiliate.

Statutory Deposits

Pursuant to UCA §31A-4-105, the Company was required, as of June 30, 2004, to maintain a deposit in the amount of its minimum capital requirement. The Company's minimum capital requirement was \$1,000,000 as determined by UCA §31A-5-211(2)(a).

The following schedule presents the statutory deposit made through the Utah Insurance Department for the primary benefit of all policyholders as of June 30, 2004.

<u>Description</u>	<u>Statement Value</u>	<u>Fair Value</u>
Colorado Health Facilities	\$ 49,000	\$ 49,142
Denton Texas Utility System Revenue	52,741	52,867
Coppell Texas Independent School District	24,946	27,222
Charleston West Virginia Parking Revenue	75,000	78,088
Metropolitan Pier & Expo AU III	43,101	55,581
Arkansas Development Finance	80,555	82,421
North Carolina Eastern Municipal Power	96,516	113,406
Portland Oregon Housing Authority	100,000	105,767
Wisconsin State Health Ed Facs	100,000	102,197
Utah State Housing Finance Agency	20,000	20,527
Salt Lake City Series A UTGO	70,000	74,014
California Health Facilities Fin Auth	100,000	104,205
Utah State Housing Finance Agency	14,650	15,167
Norwest Texas Independent School	200,000	188,362
Alaska State Housing Fin Corp Mort Rev	19,019	23,059
	<u>\$ 1,045,528</u>	<u>\$ 1,092,024</u>

Insurance Products and Related Practices

Policy Forms and Underwriting

As of June 30, 2004, the Company marketed group collateral protection policies during the period of examination through lending entities, mainly for automobile physical damage, group credit fire and group involuntary unemployment risks. These products were designed to pay off or reduce a debtor's loan balance with the lender. The Company retained 100% of all collateral protection and involuntary unemployment business, and none of the credit fire business, ceding it all to an affiliate. Policy limits were related to the value of the collateral insured. The limits for the business retained were \$50,000 for collateral protection and \$1,000 for unemployment business.

Individual private passenger physical damage and liability policies were also developed and initially marketed in 1998. The Company retained 66.7% of this business, which had a policy limit of \$300,000.

Comparisons were made of stock forms with approved forms filed with the Utah Insurance Department with no exceptions noted.

Territory and Plan of Operation

The Company was authorized to transact insurance in the States of Idaho, North Dakota, South Dakota, Utah and West Virginia as of June 30, 2004. The Certificates of Authority authorized the transaction of property, surety, liability, marine and transport, workers compensation and vehicle liability classes of business in Utah, and various similar lines of property and casualty business in the States of Idaho, North Dakota, South Dakota and West Virginia. All direct business was marketed through IAI as a general agent under a Marketing Services Agreement discussed under the section of this report entitled "Affiliated Companies" as of June 30, 2004.

Advertising and Sales Material

Sales materials, which consisted of two pamphlets, were compared with related policies with no exceptions noted.

Treatment of Policyholders

A review of the Utah Insurance Department consumer complaint files revealed no significant issues or any trends of policyholder mistreatment. A complaint log was maintained during the examination period.

Reinsurance

Assumed

The Company entered into a quota share reinsurance agreement with Old United Casualty Company (Old United) on July 1, 1995. It assumed 100% of Old United business produced by IAI, pursuant to a Managing General Agents Contract, effective July 1, 1995, between Old United and IAI. The classes of products reinsured were collateral protection, vendors single interest, binder (short term collateral protection insurance), mobile home and credit fire.

Ceded

The Company entered into a quota share reinsurance agreement with First Financial on January 1, 2000, in which it ceded a third (33 1/3%) of its non-standard auto insurance. Ceding commissions were 27% on business written directly by the Company.

The Company entered into a quota share reinsurance agreement with First Financial on January 1, 1992 in which it ceded 50% of its binder insurance. The agreement provided for ceding commissions of 60% to be paid the Company.

The Company entered into an automatic quota share reinsurance agreement with First Financial on January 1, 1991, in which it ceded 100% of its credit fire insurance. The agreement provided for ceding commissions of 5% to be paid the Company plus actual commissions paid by the Company.

The Company entered an updated trust agreement with First Financial effective January 1, 1998, which satisfied an exception in the prior report of examination disallowing unearned premium reinsurance credit.

Accounts and Records

As of June 30, 2004, the Company's accounting system consisted of a general ledger, registers, statistical and other records maintained primarily on information systems equipment and software. An AS/400 minicomputer was utilized which is accessed through personal computers.

A general ledger trial balance was taken as of June 30, 2004, and it was reconciled to the Company's second quarter statement. General ledger accounts for the years covered in the examination period were reconciled to the related annual statement accounts as deemed necessary.

Three of the Company's invested assets, held as of June 30, 2004, were not maintained in compliance with UCA § 31A-4-108 and UAC Rule R590-178. UAC Rule R590-178 specifies provisions required in the custodial agreement referenced in UCA § 31A-4-108(1). The examination recommends that the Company execute a compliant custodial agreement with their broker to ensure the safekeeping of securities being held or being temporarily held for transfer to one of their trust accounts.

Financial Statements

The following financial statements were prepared from the Company's accounting records and the valuations and determinations made during the examination:

Balance Sheet as of June 30, 2004

Underwriting and Investment Exhibit Statement of Income-
for the Six Month Period Ended June 30, 2004

Reconciliation of Capital and Surplus Account -
January 1, 2000 through June 30, 2004

The accompanying Notes to Financial Statements are an integral part of the financial statements.

Casualty Underwriters Insurance Company
Balance Sheet
as of June 30, 2004

ASSETS

	<u>Net Admitted Assets</u>
Bonds	\$ 3,594,844
Preferred stocks	2,586
Common stocks	16,545
Mortgage loans on real estate: First liens	175,446
Cash, cash equivalents and short-term investments	635,472
Other invested assets	67,306
Investment income due and accrued	55,651
Uncollected premiums and agents' balances in course of collection	487,459
Amounts recoverable from reinsurers	138,790
Net deferred tax asset	22,296
Guaranty funds receivable or on deposit	11,319
Accounts receivable	<u>456</u>
Total net admitted assets	<u><u>\$ 5,208,170</u></u>

LIABILITIES

Losses	\$ 818,752
Loss adjustment expense	63,692
Other expenses	25,675
Taxes, licenses and fees	3,571
Current federal and foreign income taxes	13,098
Unearned premiums	179,369
Ceded reinsurance premiums payable	205,388
Remittances and items not allocated	310
Due to reinsurer	246
Unearned investment income	3,356
General accounts payable	<u>222</u>
Total liabilities	<u>1,313,679</u>
Common capital stock	1,000,000
Gross paid in and contributed capital	200,000
Unassigned funds	<u>2,694,491</u>
Surplus as regards policyholders	<u>3,894,491</u>
Totals	<u><u>\$ 5,208,170</u></u>

Casualty Underwriters Insurance Company
Underwriting and Investment Exhibit Statement of Income
for the Six Month Period Ended June 30, 2004

	<u>Amount</u>
Underwriting income:	
Premium earned	<u>\$ 1,445,502</u>
Deductions:	
Losses incurred	625,700
Loss expenses incurred	53,086
Other underwriting expenses incurred	733,724
Total underwriting deductions	<u>1,412,510</u>
Net underwriting gain (loss)	<u>32,992</u>
Investment income:	
Net investment income earned	107,454
Net realized capital gains	12,592
Net investment gain (loss)	<u>120,046</u>
Other income:	
Miscellaneous income	1,095
Total other income	<u>1,095</u>
Net income before federal income taxes	154,133
Federal and foreign income taxes incurred	14,600
Net income	<u><u>\$ 139,533</u></u>

Casualty Underwriters Insurance Company
Reconciliation of Capital and Surplus Account
January 1, 2000 through June 30, 2004

	2000	2001	2002	2003	Per Exam 2004
Surplus as regards policyholders, December 31 prior year	\$ 2,824,895	\$ 2,999,137	\$ 2,871,408	\$ 3,217,745	\$ 3,704,659
Net income (loss)	157,177	5,910	191,888	548,111	139,533
Net unrealized capital gains or (losses)	23,320	1,767	(4,518)	3,003	(12,760)
Change in net deferred income tax		810	12,763	(97,128)	
Change in nonadmitted assets	(6,255)	(213,963)	121,309	52,588	16,341
Change in provision for reinsurance		(51,951)	24,895	(19,660)	46,719
Cumulative effect of changes in accounting principals		129,698			
Change in surplus as regards policyholders for the year	174,242	(127,729)	346,337	486,914	189,833
Capital and surplus end of reporting year	<u>\$ 2,999,137</u>	<u>\$ 2,871,408</u>	<u>\$ 3,217,745</u>	<u>\$ 3,704,659</u>	<u>\$ 3,894,491</u>

Notes to Financial Statements

The surplus as regards policyholders reported by the Company in its 2004 regulatory 2nd quarterly statement was \$3,894,491. No adjustments were determined necessary for examination purposes.

The Company's minimum capital requirement was \$1,000,000 pursuant to UCA § 31A-5-211. Its total adjusted capital was \$3,704,709 and authorized control level risk based capital (RBC) was \$383,061 as of June 30, 2004.

Summary

Items of significance or special interest contained in this report are summarized below:

1. The Company's minimum capital requirement was \$1,000,000 pursuant to UCA § 31A-5-211. Its total adjusted capital was \$3,704,709 and authorized control level risk-based capital (RBC) requirement was \$383,061 as of June 30, 2004. (**Notes to Financial Statements**)
2. A custodial securities agreement was not in compliance with UCA § 31A-4-108 and UAC Rule R590-178. (**Accounts and Records**)

Conclusion

The assistance and cooperation extended during the course of the examination by officers, employees and representatives of the Company is acknowledged. Mr. Glenn Taylor of Taylor-Walker and Associates, Inc. conducted the actuarial phases of the examination.

Respectfully submitted,



Allen J. Hart, CFE
Examiner-in-Charge
Utah Insurance Department